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## Trapped in Distress: How the Act 47 Program is Failing Pennsylvania's Municipalities

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## Comment

# Trapped in Distress: How the Act 47 Program is Failing Pennsylvania's Municipalities

Richard L. Armezzani\*

### Abstract

As of 2014, 19 states have passed fiscal emergency laws to address financial distress within their municipalities. Among those 19 statutes, Pennsylvania's Municipalities Financial Recovery Act ("Act 47") represents one of the most aggressive attempts to cure municipal distress. Act 47 works by empowering the recovery coordinator, a newly-created office, to design and implement a fiscal recovery plan for participating municipalities that includes both cost cutting and new revenue measures. Since its passage, 28 municipalities have opted to participate in the Act 47 program. Despite Act 47's promise to cure municipal distress, these participating municipalities have found Act 47 status to be both long-lasting and legally controversial.

Legal controversy has specifically involved Section 252 of Act 47, which limits the enforcement of certain "arbitration settlements." After a

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series of court decisions, the Pennsylvania Supreme Court in 2011's *City of Scranton* decision upended precedent and effectively nullified a key provision of the Act. Owing to outcry concerning Act 47's ineffectiveness, the Pennsylvania Legislature has also repeatedly modified Act 47. Most recently, in 2014, Act 47 was modestly reformed to include, among other provisions, a participation time limit and new revenue measures.

Despite both judicial and legislative intervention, the Act 47 program still lacks the tools necessary to successfully aid financially struggling municipalities. This Comment will argue that both judicial and legislative interventions have failed because they have not addressed the roots of municipal distress. Therefore, this Comment will argue for further legislative reform aimed at remedying several identified causes of distress. Specifically, this Comment will advocate that reform should include tax reform for non-profit entities, municipal pension reform, and regionalization of municipal services.

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## I. INTRODUCTION

In many municipalities across Pennsylvania, fiscal distress complicates governmental operations and threatens entire regions' economic prosperity. Aimed at restoring fiscal integrity and giving distressed municipalities a promising future, the Pennsylvania Municipalities Recovery Act<sup>1</sup> ("Act 47") is 1 of 19 municipal fiscal emergency statutes throughout the United States.<sup>2</sup> Unlike other fiscal emergency laws which propose solutions on an *ad hoc* basis, Act 47 creates a program designed to be a general solution for all participating municipalities.<sup>3</sup>

Despite the program's initial promise, Act 47 has largely failed to restore fiscal integrity for participating municipalities. For example, since its passage, 28 municipalities have entered the program while only 10 have successfully exited financial distress.<sup>4</sup> Beyond this track record of ineffectiveness, Act 47 has also resulted in numerous lawsuits concerning its perceived trampling of municipal public safety unions' collective bargaining rights.<sup>5</sup> While recent legislative reforms have attempted to resolve these issues,<sup>6</sup> the program remains ill-equipped to restore the fiscal integrity of Pennsylvania's municipalities.

This Comment will advocate for further systemic reform of Act 47 and show, through careful analysis of the statute's history, what successful reform should entail. Part I will provide the statute's background, including an explanation of its purpose, the criteria for

1. 53 PA. CONS. STAT. ANN. § 11701.101 *et seq.* (West Supp. 2014).

2. See Eric A. Scorsone, *MUNICIPAL FISCAL EMERGENCY LAWS: Background and Guide to State-Based Approaches* 13 (George Mason Univ. Mercatus Ctr., Working Paper No. 14-21, 2014), <http://mercatus.org/publication/municipal-fiscal-emergency-laws-background-and-guide-state-based-approaches> (detailing various statewide programs for addressing municipal financial distress).

3. See *id.*

4. See PA. DEP'T OF CMTY. & ECON. DEV., *List of Act 47 Determinations*, <http://www.newpa.com/local-government/services-we-provide-local-governments/request-assistance/list-act-47-distress-determinations> (last visited Oct. 9, 2014).

5. See *infra* Part II.D.1.

6. See *infra* Part II.D.2.

entering the program, and the increased powers available to municipalities within the program.<sup>7</sup> Part I will also provide a history of both the legal turmoil surrounding Section 252 of the statute and the legislative changes up to and including the 2014 reform legislation.<sup>8</sup>

In Part II, this Comment will discuss the seminal *City of Scranton*<sup>9</sup> decision by the Pennsylvania Supreme Court.<sup>10</sup> This discussion is included not because of the decision's precedential value, but rather for the majority and dissent's views concerning the policy behind Act 47 and the dissent's unique insight concerning the effect of legal disputes on the overall effectiveness of the program.<sup>11</sup> Part II will then analyze legislative changes made in response to the cacophony of discontent concerning the statute's effectiveness.<sup>12</sup>

Finally, Part III will advocate that further changes be made to ensure the statute's success at alleviating fiscal distress. The first recommendation is for legislative change of the tax-exempt status of non-profit entities operating within distressed municipalities.<sup>13</sup> The second recommendation suggests municipal pension reform to address the danger distressed funds pose for municipalities.<sup>14</sup> The third recommendation includes a call for regionalization of essential services to allow for reduced future costs and greater workforce professionalization.<sup>15</sup> This change would serve as an effective response to many distressed municipalities' rapidly decreasing populations.<sup>16</sup>

## II. BACKGROUND

### *A. Purpose, Legislative Intent, and Criteria for Entering the Act 47 Program*

The Municipalities Financial Recovery Act,<sup>17</sup> more commonly known as "Act 47," was enacted in 1987 to restore the "fiscal integrity"

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7. See *infra* Parts II.A-C.

8. See *infra* Parts II.D.1-2.

9. See *City of Scranton v. Firefighters Local Union No. 60, of the Int'l Ass'n of Fire Fighters*, 612 Pa. 23, 27 (Pa. 2011).

10. See *infra* Part III.A.

11. See *id.*

12. See *infra* Part III.B.

13. See *infra* Part III.C.1.

14. See *infra* Part III.C.2.

15. See *infra* Part III.C.3.

16. See *id.*

17. 53 PA. CONS. STAT. ANN. § 11701.101 (West Supp. 2014).

of Pennsylvania's struggling municipalities.<sup>18</sup> Specifically, upon passage, the Pennsylvania General Assembly declared that Act 47 would: (1) "enact procedures and provide powers"<sup>19</sup> for officials to address their municipality's fiscal crisis within their elected capacity; (2) "enact procedures for the adjustment of municipal debt";<sup>20</sup> and (3) "provide for the exercise of the Commonwealth's sovereign and plenary police power"<sup>21</sup> in the event local officials fail to adopt an Act 47 recovery plan to address municipal distress. The motivation behind adopting Act 47 was the steel industry's decline and the ensuing negative effects on the surrounding municipalities' economies and budgets.<sup>22</sup> Act 47 has since been amended to keep this narrow focus envisioned upon passage.<sup>23</sup>

### B. *Criteria for Entering the Act 47 Program*

For a municipality to be declared financially distressed and accepted into the Act 47 program, a party with standing must first request a determination of distress by the Department of Community and Economic Development ("the Department").<sup>24</sup> Act 47 lists ten parties with standing to request that a municipality be deemed financially distressed.<sup>25</sup> This list includes parties such as the Department itself, the municipality's governing body, the municipality's chief executive officer, and, among others, "ten percent of the number of electors . . . that voted at the last municipal election, by petition to the department."<sup>26</sup>

Once a determination of financial distress has been requested, the Department must then discern whether the municipality meets 1 or more of 11 distress indicators set forth within the Act.<sup>27</sup> The factors indicating

18. *Id.* § 11701.102; see also Drew Patrick Gannon, Comment, *An Analysis of Pennsylvania's Legislative Programs for Financially Distressed Municipalities and the Reaction of Municipal Labor Unions*, 98 DICK. L. REV. 281, 281 (1994).

19. 53 PA. CONS. STAT. ANN. § 11701.102(b)(1)(i).

20. *Id.* § 11701.102(b)(1)(ii).

21. *Id.* § 11701.102(b)(1)(iii).

22. See Gannon, *supra* note 18, at 281.

23. See *id.* For example, Act 47 was amended in 1991 to preclude participation by the City of Philadelphia. The General Assembly subsequently developed the Pennsylvania Intergovernmental Cooperative Authority Act to address Philadelphia's fiscal woes. For a more thorough explanation of this statute, see 53 PA. CONS. STAT. ANN. § 12720.101 (West Supp. 2014).

24. Although Act 47's original text referenced the Department of Community Affairs, in 1996, the Pennsylvania General Assembly combined the Departments of Commerce and Community Affairs to form the Department of Community and Economic Development. See Act of June 27, 1996 (P.L. 403, No. 58).

25. For an exhaustive list of parties with standing under Act 47, see 53 PA. CONS. STAT. ANN. § 11701.202.

26. *Id.* § 11701.202(1-10).

27. These factors are:

distress typically involve the existence of an ongoing budget deficit. Prime examples include the first factor, which requires that a municipality has "maintained a deficit over a three year period" and the second factor which requires that a municipality's "expenditures have exceeded revenues for a period of three years or more."<sup>28</sup> If the Department determines, based on these 11 indicators, that the municipality demonstrates significant fiscal distress, it may declare the municipality "financially distressed" under Act 47.<sup>29</sup> To aid in this determination, the Department is also authorized under Act 47 to compile financial data on municipalities and, if prompted, to use that data to determine the existence of "financial distress" or to take proactive measures to prevent distress for at-risk municipalities.<sup>30</sup>

*C. Increased Duties and Powers of Municipalities in the Act 47 Program*

Once the Department has determined that a municipality is financially distressed, it has 30 days to appoint a "recovery coordinator" for the municipality.<sup>31</sup> The coordinator must be an employee of either

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(1) The municipality has maintained a deficit over a three year period, with a deficit of 1% or more in each of the previous fiscal years; (2) The municipality's expenditures have exceeded revenues for a period of three years or more; (3) The municipality has defaulted in payment of principal or interest on any of its bonds or notes or in payment of rentals due any authority; (4) The municipality has missed a payroll for 30 days; (5) The municipality has failed to make required payments to judgment creditors for 30 days beyond the date of the recording of the judgment; (6) The municipality, for a period of at least 30 days beyond the due date, has failed to forward taxes withheld on the income of employees or has failed to transfer employer or employee contributions for Social Security; (7) The municipality has accumulated and has operated for each of two successive years a deficit equal to 5% or more of its revenues; (8) The municipality has failed to make the budgeted payment of its minimum municipal obligation as required by . . . the Municipal Pension Plan Funding Standard and Recovery Act, with respect to a pension fund during the fiscal year for which payment was budgeted and has failed to take action within that time period to make required payments; (9) The municipality has sought to negotiate resolution or adjustment of a claim in excess of 30% against a fund or budget and has failed to reach an agreement with creditors; (10) The municipality has filed a municipal debt readjustment plan pursuant to Chapter 9 of the Bankruptcy Code; (11) The municipality has experienced a decrease in a quantified level of municipal service from the preceding fiscal year which has resulted from the municipality reaching its legal limit in levying real estate taxes for general purposes.

*Id.* § 11701.201.

28. *Id.*

29. *Id.*

30. See 53 PA. CONS. STAT. ANN. § 11701.121(a) (setting forth the duties of the Department in the Act 47 program).

31. *Id.* § 11701.221(a).

the Department or an outside consulting firm and cannot be an elected official within the municipality.<sup>32</sup> Once appointed, this coordinator's primary duty is to prepare a recovery plan containing both cost-cutting measures and new revenue measures capable of alleviating the municipality's financial distress.<sup>33</sup> The recovery plan is then submitted to the municipal governing body, and once approved, it is the coordinator's responsibility to oversee its successful implementation.<sup>34</sup>

If the governing body of a municipality operating under a home rule charter or optional form of government refuses to pass the coordinator-produced recovery plan, Act 47 requires that the municipality's chief executive officer ("CEO") produce a recovery plan within 14 days.<sup>35</sup> Likewise, the CEO is similarly tasked with producing an acceptable recovery plan within 14 days if the CEO refuses to implement a coordinator-produced recovery plan accepted by the municipal governing body.<sup>36</sup> When municipalities are not operating under a home rule charter or optional form of government, the municipal governing body is tasked with producing its own recovery plan within 14 days of the coordinator-produced plan's rejection.<sup>37</sup> If the Secretary of the Department concludes that this alternate plan adequately addresses the municipality's financial distress, the alternate plan can then be adopted by ordinance and implemented by either the CEO or municipal governing body.<sup>38</sup> As an incentive to actively participate in the program, Act 47 provides for the withholding of Commonwealth funds if a municipality fails to either adopt the coordinator's plan or produce an alternate plan within the aforementioned timetable.<sup>39</sup>

Available for use in either a coordinator-crafted recovery plan or a CEO-crafted recovery plan is a special taxing power allowable only to municipalities participating in the Act 47 program.<sup>40</sup> For example, the Act includes a provision permitting the distressed municipality to petition the Court of Common Pleas<sup>41</sup> for authorization to increase real

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32. *Id.* § 11701.221(b).

33. *Id.* § 11701.221(d).

34. *Id.*

35. *Id.* § 11701.246(a).

36. *Id.* § 11701.246(a).

37. *Id.*

38. In cases in which the recovery plan was not crafted by a coordinator, the plan is implemented by its author, i.e., the municipal CEO or governing body in a non-optimal form of government. *See id.* §§ 11701.247(b)-(c).

39. *Id.* §§ 11701.251, 11701.264 (specifying in both sections that municipalities which fail to adopt a recovery plan face the withholding of grants, loans, or other Commonwealth payments not specifically excluded from these sections).

40. *See id.* § 11701.123.

41. In the Pennsylvania state judicial system, the Courts of Common Pleas are the general trial courts typically organized by county. For more information, see *Learn*,



estate or earned income tax rates beyond the state maximum.<sup>42</sup> Although this increase is only effective for a year, the city is not prevented from seeking continued yearly authorizations from the local Court of Common Pleas.<sup>43</sup>

In the event that the coordinator or city leaders determine the tax burden imposed on city residents has become excessive under the plan, the Act authorizes them to levy a commuter tax on non-residents working within the city.<sup>44</sup> Although seemingly helpful towards spreading the burden of tax increases, this option of levying a commuter tax is not without limitations. For example, the “second-class-A”<sup>45</sup> city of Scranton is prohibited under Act 47 from imposing a commuter tax unless: (1) the municipality has already increased tax rates for residents, (2) other provisions allowed within the Act have been implemented first, and (3) the additional income derived from the implementation of other tax increases has been insufficient to balance the municipal budget.<sup>46</sup> Beyond establishing the increased taxing power outlined above, Act 47 also provides that the recovery coordinator may request additional grants and emergency interest-free loans from the state.<sup>47</sup>

#### D. History of Act 47

##### 1. Court Battles Over Section 252 of Act 47

Since Act 47’s passage in 1987 and its subsequent adoption by various municipalities, Section 252 of the Act has proven controversial for limiting the collective bargaining rights of public safety unions.<sup>48</sup> Section 252 specifically provides that no arbitration settlements or agreements can “violate, expand or diminish” the provisions of a

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UNIFIED JUDICIAL SYSTEM OF PENNSYLVANIA, <http://www.pacourts.us/learn/> (last visited Nov. 7, 2014).

42. 53 PA. CONS. STAT. ANN. § 11701.123(c)(1).

43. *Id.* § 11701.123(c)(2).

44. *Id.* § 11701.123(c)(3).

45. In Pennsylvania, cities are separated into four classes corresponding primarily to their population. Currently, the only city with “second class-A” designation is Scranton. Therefore, this provision specifically limits that city’s power to levy a commuter tax. See David Singleton, *Scranton Classification Change Could Have Ripple Effect*, TIMES-TRIBUNE (May 5, 2012), <http://thetimes-tribune.com/news/scranton-classification-change-could-have-ripple-effect-1.1310968>.

46. 53 PA. CONS. STAT. ANN. §§ 11701.123(c)(3)(i)-(iii).

47. *Id.* §§ 11701.301-303.

48. See generally 53 PA. CONS. STAT. ANN. § 11701.252 (West Supp. 2014); Alaina C. Schroeder, Comment, *The Interplay Between the Municipalities Financial Recovery Act and the Policemen and Firemen Collective Bargaining Act: An Analysis of City of Scranton v. Fire Fighters Local Union No. 60*, 19 WIDENER L.J. 541 (2010).

previously adopted recovery plan.<sup>49</sup> In a myriad of court cases filed since Act 47's passage, public safety unions have argued that Section 252 violates the Policemen and Firemen Collective Bargaining Act ("Act 111"),<sup>50</sup> which provides for binding arbitration in the event of a negotiation impasse between a public employer and a police or firefighters union.<sup>51</sup>

#### a. Development of Court Precedent

This issue concerning the interplay between Act 47 and Act 111 was first litigated in *Wilkesburg Police Officers Ass'n v. Commonwealth*.<sup>52</sup> In this suit, the Wilkesburg Police Officers' Association sought a declaratory judgment that Act 47's conflict with Act 111 was in violation of the Pennsylvania Constitution's guarantee of collective bargaining rights for police and fire associations.<sup>53</sup> The Commonwealth Court<sup>54</sup> held that, although Act 111 was passed pursuant to Article III Section 31 of the Pennsylvania Constitution, which concerned the passage of laws providing for public safety unions' collective bargaining rights, the General Assembly was also authorized to pass laws "limit[ing] police officers' statutory rights to collective bargaining."<sup>55</sup> On appeal, the Pennsylvania Supreme Court affirmed the Commonwealth Court's finding and further stated that "even if section 252 of Act 47 operates as a bar to prospective bargaining agreements," it would still not violate Article III, Section 31 of the Pennsylvania Constitution.<sup>56</sup>

A year later in *City of Farrell v. Fraternal Order of Police, Lodge No. 34*,<sup>57</sup> the Pennsylvania Supreme Court considered whether a police union's arbitration award, reached by a board of arbitration after the city

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49. 53 PA. CONS. STAT. ANN. § 11701.252(a).

50. 43 PA. CONS. STAT. ANN. § 217.4 (West 2011).

51. *See id.*

52. *Wilkesburg Police Officers Ass'n v. Commonwealth (Wilkesburg I)*, 564 A.2d 1015, 1020 (Pa. Commw. Ct. 1989), *aff'd*, *Wilkesburg Police Officers Ass'n v. Commonwealth (Wilkesburg II)*, 636 A.2d 134 (Pa. 1993).

53. *See Wilkesburg I*, 564 A.2d at 1020; *see also* PA. CONST. art. III, § 31 (providing that the "General Assembly may enact laws . . . for collective bargaining between policemen and firemen and their public employers [that] shall be binding upon all parties").

54. In the Pennsylvania state judicial system, the Commonwealth Court is one of two intermediary appellate courts. It is "primarily responsible for matters involving state and local governments and regulatory agencies." For more information, see UNIFIED JUDICIAL SYSTEM OF PENNSYLVANIA, *supra* note 41.

55. *Wilkesburg I*, 564 A.2d at 1020.

56. *Wilkesburg II*, 636 A.2d at 140.

57. *City of Farrell v. Fraternal Order of Police, Lodge No. 34*, 645 A.2d 1294 (Pa. 1994).

and police union failed to ratify a new collective bargaining agreement, violated the city's Act 47 recovery plan.<sup>58</sup> Because the City of Farrell had been designated as "financially distressed" under Act 47, the city sought a declaratory judgment that the arbitration award contained provisions that violated the previously adopted recovery plan and, thus, could not be enforced.<sup>59</sup> The Supreme Court held, however, that although the arbitration award was determined post-recovery plan, the salary increases did not conflict with the plan's provisions.<sup>60</sup> Therefore, despite a factual disagreement with the Commonwealth Court concerning whether salary increases violated the recovery plan, the Supreme Court implicitly affirmed the Commonwealth Court's finding that Section 252 would prohibit "any arbitration award executed after the adoption of a recovery plan . . . which violate[s], expand[s], or diminish[es] any provisions of the plan."<sup>61</sup>

Based on the Pennsylvania Supreme Court's holdings in both *Wilkinsburg* and *City of Farrell*, the Commonwealth Court held in decisions from 2005 through 2010 that Section 252 of Act 47 applies to both arbitration "settlements" and "determinations."<sup>62</sup> The Court reached this conclusion repeatedly despite the absence of the term "determination" within the definitions section of the Act.<sup>63</sup> In *Pittsburgh Fire Fighters, Local No. 1 v. Yablonsky*,<sup>64</sup> the Commonwealth Court held that, even though Section 252 of Act 47 did not specifically reference arbitration determinations, the General Assembly, "in referring to collective bargaining agreements or arbitration settlements in Act 47, was referring to arbitration awards, whether it used the word settlement or determination."<sup>65</sup> Similarly, in *Int'l Ass'n of Firefighters Local 1400, Chester City Firefighters v. City of Chester*,<sup>66</sup> the Commonwealth Court again held that Section 252 of Act 47 applies to arbitration awards as well as to settlements and collective bargaining agreements.<sup>67</sup> Despite court precedent concerning the breadth of Section 252, the Act 47 City of

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58. *Id.* at 1295-96.

59. *Id.* at 1295.

60. *Id.* at 1299.

61. *Id.* at 1297 (quoting the finding of the Commonwealth Court and basing the subsequent factual determination on that premise).

62. See, e.g., *Int'l Ass'n of Firefighters Local 1400, Chester City Firefighters v. City of Chester*, 991 A.2d 1001, 1010 (Pa. Commw. Ct. 2010); *Pittsburgh Fire Fighters, Local No. 1 v. Yablonsky*, 867 A.2d 666, 671 (Pa. Commw. Ct. 2005).

63. See *Chester City Firefighters*, 991 A.2d at 1010; *Yablonsky*, 867 A.2d at 671.

64. *Pittsburgh Fire Fighters, Local No. 1 v. Yablonsky*, 867 A.2d 666 (Pa. Commw. Ct. 2005).

65. *Id.* at 671.

66. *Int'l Ass'n of Firefighters Local 1400, Chester City Firefighters v. City of Chester*, 991 A.2d 1001 (Pa. Commw. Ct. 2010).

67. *Id.* at 1010.

Scranton's public safety unions appealed, in 2009, an adverse Commonwealth Court decision<sup>68</sup> and argued that Section 252 does not apply to arbitration awards.

b. *City of Scranton* and Aftermath

Just when Pennsylvania courts appeared to have settled on a broad interpretation of Section 252, the Pennsylvania Supreme Court upended that interpretation in favor of a much narrower view.<sup>69</sup> In *City of Scranton v. Firefighters Local Union No. 60, of the Int'l Ass'n of Fire Fighters*,<sup>70</sup> the Pennsylvania Supreme Court held that Section 252 of Act 47 did not apply to "interest arbitration awards under Pennsylvania's Policemen and Firemen Collective Bargaining Act," which were reached following the adoption of a recovery plan.<sup>71</sup> In doing so, the Pennsylvania Supreme Court reversed the Commonwealth Court, which had upheld the trial court's vacation of the award.<sup>72</sup>

In its opinion, the Pennsylvania Supreme Court reasoned that prior court opinions in *Wilkesburg* and *City of Farrell* were not controlling as to whether Section 252 applied to "arbitration awards."<sup>73</sup> In support thereof, the Court reasoned that these prior holdings were based on an assumption that Section 252 applied to arbitration awards and not a "binding holding grounded on developed reasoning."<sup>74</sup> Without binding precedent, the Court determined, after referencing both Merriam-Webster Dictionary and Black's Law Dictionary, that Section 252's language concerning "arbitration settlements" was "sufficiently ambiguous to warrant reference to tools of statutory construction."<sup>75</sup> Specifically, the court considered "the occasion and necessity for the statute; the object to be attained by the enactment under review; the consequences of specific interpretations; and the manner in which the Legislature would have likely intended for Act 47 to interact with Act 111" in order to best determine the legislature's intent concerning the interplay between Acts 47 and 111.<sup>76</sup>

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68. See generally *City of Scranton v. Firefighters Local Union No. 60, of the Int'l Ass'n of Fire Fighters*, 964 A.2d 464 (Pa. Commw. Ct. 2009), *rev'd*, 612 Pa. 23, 27 (Pa. 2011).

69. See *City of Scranton v. Firefighters Local Union No. 60, of the Int'l Ass'n of Fire Fighters*, 612 Pa. 23, 27 (Pa. 2011).

70. *Id.*

71. *Id.* at 50.

72. See *id.* at 34-35.

73. See *id.* at 44.

74. *City of Scranton*, 612 Pa. at 45.

75. *Id.* at 46.

76. *Id.* at 46-47.

Through this consideration, the Court found that Act 111's underlying purpose of preventing labor strife outweighed the public policy of Act 47, namely curing municipal financial distress.<sup>77</sup> In fact, the Court stated that the "great difficulty arising between the City [of Scranton] and the Unions in accepting each other's good faith" demonstrates the exact circumstances that motivated the Pennsylvania Legislature to initially pass Act 111.<sup>78</sup> With the Court now resolved that the public policy underlying Act 111 trumped the public policy underlying Act 47, it distinguished the *Yablonsky* finding that "the General Assembly . . . was referring to arbitration awards, whether it used the word settlement or determination."<sup>79</sup> Specifically, the Court reasoned that the *Yablonsky* rationale "rest[ed] more on the notion that Section 252 must extend to arbitration awards to vindicate Act 47's policy objectives than upon a textual evaluation . . ."<sup>80</sup> Therefore, because the Court had previously reached an opposite conclusion concerning the weighing of public policy, it attributed no weight to *Yablonsky*'s finding and held that "Section 252 of Act 47 does not impinge upon interest arbitration awards under the Policemen and Firemen Collective Bargaining Act."<sup>81</sup>

Despite this ruling's sweeping nature, the Pennsylvania Supreme Court was not finished reversing Commonwealth Court precedent concerning Act 47.<sup>82</sup> Four months later, in *City of Scranton v. E.B. Jermyn Lodge of No. 2 of Fraternal Order of Police*,<sup>83</sup> the Pennsylvania Supreme Court again vacated the Commonwealth Court's holding and issued an order in favor of the union appellant based on a similar dispute concerning arbitration awards for the Scranton police officer's union.<sup>84</sup>

The aftermath of these decisions devastated the City of Scranton's finances.<sup>85</sup> Saddled with a \$30 million arbitration award for both the police and fire unions, the city has struggled to secure funding to pay the award and, as a result, has seen its financial situation further

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77. *See id.*

78. *Id.* at 47.

79. *See City of Scranton*, 612 Pa. 23 at 48 (citing *Pittsburgh Fire Fighters, Local No. 1 v. Yablonsky*, 867 A.2d 666, 671 (Pa. Commw. Ct. 2005)).

80. *See id.*

81. *See id.* at 50.

82. *See generally* *City of Scranton v. E.B. Jermyn Lodge of No. 2 of Fraternal Order of Police*, 614 Pa. 457 (Pa. 2012).

83. *City of Scranton v. E.B. Jermyn Lodge of No. 2 of Fraternal Order of Police*, 614 Pa. 457 (Pa. 2012).

84. *Id.* at 458.

85. *See generally* Romy Varghese, *Scranton Strains Under Pennsylvania Ruling Cutting Fiscal Repair Measure*, BLOOMBERG (Feb. 13, 2012, 12:01 AM), <http://www.bloomberg.com/news/2012-02-13/pennsylvania-s-scranton-strains-under-ruling-cutting-fiscal-repair-measure.html>.

deteriorate.<sup>86</sup> Fearing other ill-effects likely to result from the *City of Scranton* decisions, the Pennsylvania General Assembly quickly amended the definitions section of Act 47 to specify that the term “arbitration settlement” explicitly includes a “final or binding arbitration award or determination.”<sup>87</sup> This amendment would be the first in a series of amendments to improve Act 47’s effectiveness.<sup>88</sup>

## 2. Legislative Changes to Act 47

Even before the Pennsylvania Supreme Court’s *City of Scranton* decisions devastated Scranton’s finances, there was reason to question Act 47’s overall effectiveness.<sup>89</sup> Since its passage in 1987, 28 municipalities have entered the program, but only 10 have successfully exited financial distress.<sup>90</sup> Despite this modest success for a limited number of participants, the program’s overall record is poor, and the Pennsylvania Legislature has responded by making largely piecemeal and reactionary modifications.<sup>91</sup>

### a. Early Legislative Changes

The first major modification of the Act 47 program occurred in 1996, when the General Assembly added a three-pronged test for “second class-A” cities wishing to impose a commuter tax.<sup>92</sup> This modification was a response to the unsuccessful and controversial attempt by Scranton, as the only “second class-A” city in the state, to institute a commuter tax.<sup>93</sup> This section’s restriction, passed as result of

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86. See *id.*; Terrie Morgan-Besecker, *Scranton Pension Funds Will Be Broke in 3 to 5 Years*, TIMES-TRIBUNE (Aug. 28, 2014), <http://thetimes-tribune.com/news/scranton-pension-funds-will-be-broke-in-3-to-5-years-1.1742563> (explaining that Scranton pension funds’ insolvency was exacerbated by the arbitration award of 2011).

87. See 2011 Pa. SB 1321 (amending Section 103 of Act 47 to specifically include “arbitration award or other determination” within the definition of “arbitration settlement”); Melissa Daniels, *Bill to Clarify Act 47 Moving Through Pennsylvania Senate*, PA INDEPENDENT (May 29, 2012), <http://paindependent.com/2012/05/bill-to-clarify-act-47-arbitration-moving-through-pennsylvania-senate/> (quoting Senate Majority Leader Pileggi that amendment was essential because the *City of Scranton* decision “effectively gutted the Act 47 statute”).

88. See *infra* Parts II.D.2.a-b.

89. See Schroeder, *supra* note 48, at 551-53 (questioning Act 47’s effectiveness considering the pre-*City of Scranton* burdens it placed on public safety unions and the program’s lack of success in alleviating distress).

90. See *List of Act 47 Determinations*, *supra* note 4.

91. See Gary Lewis, *An introduction to Act 47, Pennsylvania’s “roach motel” for distressed cities*, PUBLICSECTORINC.ORG (Dec. 3, 2013), <http://www.publicsectorinc.org/2013/12/an-introduction-to-act-47-pennsylvanias-roach-motel-for-distressed-cities>.

92. See Act of July 11, 1996 (P.L. 645, No. 108); Lewis, *supra* note 91.

93. See *id.*

local legislators' efforts, remains applicable only to the City of Scranton.<sup>94</sup>

The next modification of Act 47 occurred in response to the City of Harrisburg's descent into municipal distress.<sup>95</sup> Because of Harrisburg's unwillingness to adopt a recovery plan under the Act 47 program, the General Assembly moved in 2011 to amend the Act to provide for the appointment of a receiver in the event of a fiscal emergency.<sup>96</sup> This amendment, applied quickly in the City of Harrisburg, allows for the governor to declare a "fiscal emergency" if the distressed municipality has failed to adopt a recovery plan and faces insolvency within a period of 180 days.<sup>97</sup>

Once a fiscal emergency is declared, the amendment further allows the governor to, among other powers, "obtain emergency financial aid for the distressed city,"<sup>98</sup> "modify the emergency action plan,"<sup>99</sup> and "issue an order . . . to implement the emergency action plan."<sup>100</sup> Furthermore, the amendment also allows the Secretary of the Department to appoint a receiver who is tasked with: (1) implementing the emergency action plan; (2) developing a permanent recovery plan; and (3) executing that recovery plan.<sup>101</sup> Passed with the City of Harrisburg in mind, receivership was formally instituted there in November 2011.<sup>102</sup> After more than two years under state control, Harrisburg formally exited receivership on March 1, 2014, but is currently participating in the Act 47 program.<sup>103</sup>

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94. *See id.*

95. *See* Romy Varghese, et al., *Harrisburg Files for Bankruptcy on Overdue Incinerator Debt*, BLOOMBERG (Oct. 12, 2011 2:14 PM), <http://www.bloomberg.com/news/2011-10-12/pennsylvania-capital-harrisburg-files-for-bankruptcy-over-incinerator-debt.html>.

96. *See* Act of October 20, 2011 (P.L. 318, No. 79); LOCAL GOV'T COMM'N, GEN. ASSEMBLY OF THE COMMONWEALTH OF PA., 2013 TASK FORCE REPORT ON ACT 47 OF 1987, MUNICIPALITIES FINANCIAL RECOVERY ACT 16 (Oct. 16, 2013), <http://www.lgc.state.pa.us/download.cfm?file=/Reports/act47/101713/Act%2047-of-1987-2013-Task-Force-Report-FINAL-10-16-2013.pdf>; Laura Vecsey, *Sen. Jeff Piccola Amends Bill that Would Allow State to Take Over Harrisburg*, PENNLIVE.COM (updated June 21, 2011, 7:39 PM), [http://www.pennlive.com/midstate/index.ssf/2011/06/sen\\_jeff\\_piccola\\_amends\\_bill\\_t.html](http://www.pennlive.com/midstate/index.ssf/2011/06/sen_jeff_piccola_amends_bill_t.html).

97. *See* 53 PA. CONS. STAT. ANN. § 11701.702(a)(West Supp. 2014).

98. *Id.* § 11701.604(a)(2).

99. *Id.* § 11701.604(a)(4).

100. *Id.* § 11701.604(b).

101. *Id.* § 11701.702(a).

102. *See* Sean Simmers, *Court Order Ends Harrisburg's State Receivership Saturday*, PENNLIVE.COM (updated Feb. 26, 2014, 9:12 AM), [http://www.pennlive.com/midstate/index.ssf/2014/02/judge\\_orders\\_city\\_receivership.html](http://www.pennlive.com/midstate/index.ssf/2014/02/judge_orders_city_receivership.html).

103. *Id.*

## b. 2014 Reform

Despite Harrisburg's success in exiting Act 47's new receivership provision, it and other cities still languish in the broader Act 47 program.<sup>104</sup> Recently, the movement to further reform Act 47 has gained momentum and, in fact, Governor Tom Corbett signed a reform bill into law on October 31, 2014.<sup>105</sup> This reform bill was passed with the added legislative intent of "enact[ing] procedures to provide municipalities showing early indications of financial distress with training and technical and financial assistance."<sup>106</sup> The bill contained the foregoing modest reforms to accomplish this legislative intent.

### 1. The Early Intervention Program

To provide at-risk municipalities with training and technical assistance, the 2014 Act 47 reform legislation created "The Early Intervention Program," which has the stated goal of "provid[ing] guidance and assistance through grants to a municipality seeking to ensure fiscal stability by developing and implementing long-term financial, managerial and economic development strategies."<sup>107</sup> Seeking to prevent financial distress in at-risk municipalities, the grants awarded are limited to funding activities or studies thought to achieve that goal, such as the development of "multi-municipal or regional intergovernmental cooperation initiatives" and, among other programs, the completion of "a merger or consolidation study."<sup>108</sup> Acceptance into the Early Intervention Program is based on factors which evaluate both a municipality's future fiscal health and its willingness to accept the management expertise provided through the program.<sup>109</sup>

### 2. Participation Time Limit

Apart from establishing the Early Intervention Program for at-risk municipalities, the 2014 reform legislation also made modest changes

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104. Municipalities still participating in the program include Pittsburgh, Reading, Scranton, and Harrisburg, or the state's second, fifth, sixth, and ninth most populous cities, respectively. See *List of Act 47 Determinations*, *supra* note 4.

105. See Robert Swift, *Distressed Cities Law Stresses Proactive Role*, TIMES-TRIBUNE (Nov. 4, 2014), <http://thetimes-tribune.com/news/distressed-cities-law-stresses-proactive-role-1.1782425>.

106. See H.B. 1773, 198th Gen. Assemb., Reg. Sess. (Pa. 2014).

107. See *id.*

108. See *id.*

109. For an exhaustive list of factors for evaluating a municipality's eligibility for the Early Intervention program, see H.B. 1773, 198th Gen. Assemb., Reg. Sess. (Pa. 2014).



that affect municipalities already participating in the Act 47 program.<sup>110</sup> The most significant reform has been imposing a five-year time limit on Act 47 participation.<sup>111</sup> At the beginning of the final year within the program, the coordinator is tasked with completing a report detailing the municipality's financial condition.<sup>112</sup> Within the report, the coordinator must recommend one of four options based on financial conditions: (1) the termination of distressed status;<sup>113</sup> (2) the disincorporation of the municipality; (3) the imposition of a fiscal emergency; or (4) the creation of a three-year exit plan from the Act 47 program.<sup>114</sup> After this five-year term, participating municipalities would be eligible for a single three-year extension.<sup>115</sup> If, however, the municipality is still financially distressed after the three-year exit plan, a fiscal emergency under Section 7 of the Act would be declared with the municipality facing possible state receivership.<sup>116</sup>

### 3. New Tax Options

The 2014 Act 47 reform legislation also created modest new tax options for distressed municipalities.<sup>117</sup> For example, under the 2014 reforms, distressed municipalities can now collect a Local Services Tax<sup>118</sup> at a maximum rate of \$156.<sup>119</sup> This triples the initial maximum of \$52 dollars.<sup>120</sup> This tripling of the tax rate, however, comes with an important restriction. Any municipality that increases the Local Services Tax by ordinance is prohibited "from imposing any additional tax on

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110. See generally William Kibler, *Leaders split on amendments to Act 47*, ALTOONA MIRROR (Nov. 9, 2014), <http://www.altoonamirror.com/page/content.detail/id/597796/Leaders-split-on-amendments-to-Act-47.html?nav=742>.

111. See H.B. 1773, 198th Gen. Assemb., Reg. Sess. (Pa. 2014).

112. See *id.*

113. The 2014 reforms also create a procedure for and factors to be considered in the termination of a municipality's distressed status. For an exhaustive list of these factors, see H.B. 1773, 198th Gen. Assemb., Reg. Sess. (Pa. 2014).

114. See H.B. 1773, 198th Gen. Assemb., Reg. Sess. (Pa. 2014).

115. *Id.*

116. *Id.*

117. See generally Robert Swift, *Tax could triple under Act 47 plan*, TIMES-TRIBUNE (June 19, 2014), <http://thetimes-tribune.com/news/tax-could-triple-under-act-47-plan-1.1705643>.

118. See H.B. 1773, 198th Gen. Assemb., Reg. Sess. (Pa. 2014).

119. The Local Services Tax is "a local tax payable by all individuals who hold a job or profession within a taxing jurisdiction imposing the tax." See *Local Services Tax (LST-1): Frequently Asked Questions*, BERKHEIMER TAX ADMINISTRATOR, <http://www.hab-inc.com/faqs/employer-local-services-tax-faq> (last visited Nov. 10, 2014).

120. See 53 PA. CONS. STAT. ANN. § 6924.311(8)(West Supp. 2014)(limiting the maximum local services tax rate for non-distressed municipalities to \$52 dollars per year).

earned income.”<sup>121</sup> Furthermore, a municipality that imposes an earned income tax on residents and non-residents working within the city<sup>122</sup> is restricted from levying a Local Services Tax above \$104 per year.<sup>123</sup>

Another taxing option included within the 2014 reform legislation is the imposition of a Payroll Preparation Tax pursuant to approval by the local Court of Common Pleas.<sup>124</sup> The proceeds of this new taxing power are limited, however, to “a rate that is sufficient to produce revenues equal to revenues collected as a result of a business privilege tax and a mercantile tax.”<sup>125</sup> Therefore, if a distressed municipality petitions the Court of Common Pleas for authority to impose such a tax, it would sacrifice the authority to levy a business privilege tax and a mercantile tax, and would, as a result, fail to net increased revenue.<sup>126</sup>

#### 4. Increased Coordinator Accountability

The 2014 reforms also increased the recovery coordinator’s accountability to its appointed municipality and created a process for dismissing ineffective coordinators.<sup>127</sup> Specifically, the reform legislation states that the Secretary of the Department is to conduct an annual review of all coordinators to determine if they are complying with both their recovery contract and Act 47 and if they have been effective in providing assistance in creating and implementing a recovery plan.<sup>128</sup> If the Secretary of the Department finds a deficiency in either area, the coordinator’s contract may be terminated.<sup>129</sup>

### III. ANALYSIS: THE *CITY OF SCRANTON* DECISION, 2014 REFORM, AND A RECOMMENDATION FOR FURTHER REFORM OF ACT 47

As evidenced by the previously discussed court cases, legislative reforms, and large number of municipalities languishing within the program, Act 47 has proven controversial because of its perceived conflict with public safety unions’ collective bargaining rights and its lackluster record of actually curing municipal distress. Starting with the

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121. See H.B. 1773, 198th Gen. Assemb., Reg. Sess. (Pa. 2014).

122. Under the Municipal Pension Plan Funding Standard and Recovery Act (“Act 205”), a financially distressed municipality with a level II or level III distressed pension plan is authorized to impose an earned income tax rate on both residents and non-residents above the state maximum with proceeds strictly for the benefit of municipal pension plans. See 53 PA. CONS. STAT. ANN. § 895.607(f)(West Supp. 2014).

123. See H.B. 1773, 198th Gen. Assemb., Reg. Sess. (Pa. 2014).

124. See *id.*

125. *Id.*

126. See *id.*

127. See H.B. 1773, 198th Gen. Assemb., Reg. Sess. (Pa. 2014).

128. See *id.*

129. See *id.*

seminal *City of Scranton* decision, the movement to strengthen Act 47 has gained momentum; however, as the decision itself demonstrates, any reform must address the underlying causes of municipal distress. This analysis will argue that reform thus far has failed to address these causes and further legislative action is needed to truly alleviate municipal distress.

### *A. The City of Scranton Decision and Its Significance*

In the litany of cases dating from Act 47's initial passage, both the Pennsylvania Commonwealth Court and the Pennsylvania Supreme Court have grappled with legal issues concerning Section 252 of Act 47 and whether the term "arbitration settlement" is included within Section 252.<sup>130</sup> The Pennsylvania Supreme Court resolved the issue of Section 252's constitutionality early on, in *Wilksburg*.<sup>131</sup> Furthermore, as described above, the courts also found that Section 252 of Act 47 limited both "arbitration settlements" and "arbitration determinations" in the form of an arbitration award.<sup>132</sup> In 2011's *City of Scranton* decision, the Pennsylvania Supreme Court backpedaled on this precedent and held that Section 252's limitation on public safety unions' collective bargaining rights does not include arbitration "determinations or awards" which violate a previously adopted recovery plan.<sup>133</sup>

#### 1. Analysis of the Majority Opinion

As previously discussed, the Pennsylvania Supreme Court in the *City of Scranton* decision reasoned that prior Supreme Court opinions in *City of Farrell* and *Wilksburg* were not controlling as to whether the term "arbitration settlement" within Section 252 applied to "arbitration awards."<sup>134</sup> Placed within a footnote to the court's opinion, however, is the majority's recognition that the *City of Farrell* court had reached its holding based on an agreement with the Commonwealth Court that "[S]ection 252 of Act 47 prohibits [a recovery plan] from being violated,

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130. See generally *City of Farrell v. Fraternal Order of Police, Lodge No. 34*, 645 A.2d 1294 (Pa. 1994); *Wilksburg Police Officers Ass'n v. Commonwealth (Wilksburg II)*, 636 A.2d 134 (Pa. 1993); *Int'l Ass'n of Firefighters Local 1400, Chester City Firefighters v. City of Chester*, 991 A.2d 1001 (Pa. Commw. Ct. 2010); *Pittsburgh Fire Fighters, Local No. 1 v. Yablonsky*, 867 A.2d 666 (Pa. Commw. Ct. 2005).

131. See *Wilksburg II*, 636 A.2d at 139.

132. *Id.*

133. See *City of Scranton v. Firefighters Local Union No. 60, of the Int'l Ass'n of Fire Fighters*, 612 Pa. 23, 27 (Pa. 2011).

134. See *supra* Part II.D.1.b.

expanded or diminished by [an] arbitration award.”<sup>135</sup> Therefore, although the court in *City of Scranton* reasoned that the *City of Farrell* holding was limited to whether the arbitration award violated Farrell’s recovery plan, this holding was based on the court’s acceptance of the Commonwealth Court’s conclusion that Section 252 prohibited an arbitration award from violating the provisions of a previously adopted recovery plan.<sup>136</sup>

Furthermore, within that same footnote, the majority in *City of Scranton* quotes the court in *City of Farrell* as stating that the determination of whether the arbitration award violated the recovery plan represented “the end of the inquiry.”<sup>137</sup> Although the court in *City of Farrell* had stated that its inquiry only extended to whether the arbitration award violated the provisions of the previously adopted recovery plan, closer inspection of the opinion shows that the court was not excluding from its inquiry whether Section 252 of Act 47 included arbitration awards, as the court in *City of Scranton* suggests. The court was instead choosing not to review the Commonwealth Court’s inquiry as to “whether the arbitration award substituted the discretion of the arbitrators for that of Farrell’s elected officials under Act 47 in establishing the priorities in the application of available revenues.”<sup>138</sup> In fact, as previously discussed, the court in *City of Farrell* had already accepted the finding of the Commonwealth Court that Section 252 disallowed arbitration awards in violation of previously adopted recovery plans.<sup>139</sup>

Because the Pennsylvania Supreme Court in *City of Scranton* did not find controlling precedent on the issue of arbitration awards, it instead conducted a plain-meaning analysis of the term “arbitration settlement.”<sup>140</sup> As previously discussed, the Court found the term to be “sufficiently ambiguous” and moved to determine the legislative intent concerning the interplay between Acts 47 and 111.<sup>141</sup> Finding that Act 111’s purpose of preventing labor strife outweighed the policy of aiding distressed municipalities, the majority, as described above,<sup>142</sup> settled on

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135. See *City of Farrell*, 645 A.2d at 1297 (quoting Fraternal Order of Police, Lodge No. 34 v. City of Farrell, 590 A.2d 1327, 1332 (Pa. Commw. Ct. 1991)).

136. See *id.*

137. See *City of Scranton*, 612 Pa. at 46 n.21 (quoting *City of Farrell*, 645 A.2d at 1299).

138. See *City of Farrell*, 645 A.2d at 1297, 1299.

139. See *City of Farrell*, 645 A.2d at 1297 (quoting Fraternal Order of Police, Lodge No. 34 v. City of Farrell, 590 A.2d 1327, 1332 (Pa. Commw. Ct. 1991)).

140. See *City of Scranton*, 612 Pa. at 46.

141. See *supra* Part II.D.1.b.

142. See *supra* Part II.D.1.b.

an interpretation of Act 47 which devastated Scranton's finances and increased concerns over Act 47's effectiveness.

## 2. Analysis of the Dissent

Although the *City of Scranton* majority had offered a forceful argument that public policy favored excluding "arbitration awards" from Act 47's reach, Judge Castille's dissent offered a compelling counter-argument concerning the importance of municipal financial stability.<sup>143</sup> This counter-argument provided perspective on the ongoing labor disputes' effect on the citizens and other stakeholders within distressed municipalities.<sup>144</sup> Like the majority, the dissent first found the term "arbitration settlement" to be ambiguous; however, when viewed as shorthand for the phrase "the settlement of disputes by arbitration," the dissent argued that the plain meaning of the term would naturally encompass arbitration awards which serve to "accomplish an adjustment or settlement of grievances or disputes."<sup>145</sup>

Beyond disagreeing over the plain meaning of "arbitration settlement," the dissent also argued persuasively that the public policy behind Act 111 does not outweigh the goals of Act 47.<sup>146</sup> Specifically, the dissent argued that, because Act 47's purpose is to alleviate fiscal distress and prevent it from "adversely affect[ing] the health, safety, and welfare of citizens in the municipality," the curtailment of personnel costs, as provided for in Section 252, is a necessary means of fulfilling that purpose.<sup>147</sup> Furthermore, while the dissent recognized Act 111's important function of "maintaining the historic balance between labor and municipal employers," it also rightly acknowledged that in times of municipal distress when labor disputes become particularly common, the majority's interpretation of Section 252 would be counterintuitive because it would allow "both labor and the municipality to continue with business as usual."<sup>148</sup>

Finally, the dissent spoke to both the significance of this particular dispute with organized labor and the need for Act 47 to address the causes of distress in order to achieve success for its participants.<sup>149</sup> As previously discussed, the dissent first underscored the need for comprehensively redressing escalating personnel costs to alleviate

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143. See generally *City of Scranton*, 612 Pa. at 51 (Castille, J., dissenting).

144. See *id.*

145. *Id.* at 53.

146. See generally *id.*

147. *Id.* at 54.

148. See *City of Scranton*, 612 Pa. at 54 (Castille, J., dissenting).

149. See *id.* at 55.

financial distress.<sup>150</sup> The dissent also rightly recognized, however, that this legal dispute with organized labor is a battle that, regardless of the victor, produces a result that “increase[s] the financial burden on other municipal stakeholders.”<sup>151</sup> As evidenced in the 2014 reforms, those stakeholders facing an “increased burden” are both residents and non-residents working within the city who have already sacrificed for their municipality.<sup>152</sup> Therefore, if Act 47 intends to “involve all stakeholders . . . to ensure the financial well-being of a municipality” as the dissent argues,<sup>153</sup> then reform needs to “enlarge the pie” of those making sacrifices and address the underlying causes of distress.

### *B. 2014 Legislative Reforms and Their Significance*

In response to the *City of Scranton* decision, the Pennsylvania Legislature quickly amended the definition of “arbitration settlement” within Section 252 to include “final or binding arbitration award[s] or other determination[s].”<sup>154</sup> Despite this change and the creation of a provision in 2012 for state receivership,<sup>155</sup> calls for comprehensive Act 47 reform grew louder as municipalities continued to struggle within the program.<sup>156</sup> In response, the Pennsylvania Legislature enacted the 2014 reform bill, which imposes a participation deadline, ensures greater coordinator accountability, includes new but limited taxing powers, and creates an early intervention program for at-risk municipalities.<sup>157</sup>

#### 1. Analysis of the New Time Limit on Act 47 Participation

The most promising 2014 reform is the imposition of a participation time limit in the Act 47 program. Enacted upon the recommendation of the Municipalities Financial Recovery Act 2013 Task Force Report,<sup>158</sup>

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150. *See id.*

151. *See id.*

152. As previously discussed, the subsequent 2014 reforms of Act 47 include tripling the Local Services Tax affecting commuters. *See* Swift, *supra* note 117.

153. *See City of Scranton*, 612 Pa. at 55 (Castille, J., dissenting).

154. *See* 2011 Pa. SB 1321 (amending Section 103 of Act 47 to specifically include “arbitration award or other determination” within the definition of “arbitration settlement”).

155. *See* Act of October 20, 2011 (P.L. 318, No. 79).

156. *See* Emily Previti, *How does Pennsylvania's distressed communities law (Act 47) work?*, KEYSTONE CROSSROADS (June 24, 2014), <http://crossroads.newsworks.org/index.php/local/keystone-crossroads/69588-how-does-pennsylvanias-distressed-communities-law-act-47-work> (explaining that, as of June 24, 2014, “[t]he Act 47 success rate . . . is 25 percent (seven of 28)”).

157. *See* H.B. 1773, 198th Gen. Assemb., Reg. Sess. (Pa 2014). For a full explanation of 2014's reforms, *see supra* Part II.D.2.b.

158. The Municipalities Financial Recovery Act 2013 Task Force Report was prepared by the “Local Government Commission, a legislative service agency, providing

this provision creates an eight-year limitation on participation.<sup>159</sup> Because the Task Force found that Act 47's effectiveness was weakened by both its unlimited cap on participation and the Commonwealth's static amount of power throughout a municipality's participation,<sup>160</sup> distressed municipalities now face greater state control after the expiration of this eight-year participation.<sup>161</sup> Specifically, the municipality faces state receivership as provided for under Section 7 of Act 47.<sup>162</sup>

As discussed within the Municipalities Financial Recovery Act 2013 Task Force Report, municipalities often languish within the program after some initial stabilizing success because they are either "nonviable" or are hamstrung by labor-related issues such as "poor labor negotiations on the part of the municipality, unwillingness of labor unions to reach contract agreements, or adverse arbitration decisions."<sup>163</sup> In the case of non-viable communities, which are either aware or unaware of this reality, the timeline offers an exit strategy for such municipalities after the initial five-year period. For instance, if the recovery coordinator finds that the municipality remains distressed at the end of the initial five-year participation period, he is now charged with recommending the disincorporation of the nonviable municipality.<sup>164</sup> Because such a recommendation is fraught with negative political consequences,<sup>165</sup> imposing a participation time limit largely removes the temptation of inaction and forces both the municipal leaders and recovery coordinator to make the difficult, and likely unpopular, recommendation of disincorporation.

In cases in which negative labor relations hinder a municipality's exit from the Act 47 program, the 2014 participation time limit has the similar effect of forcing the politically unpalatable result of compromise. Because both the municipal leaders and the city's labor union leaders fear the loss of local autonomy to state receivership, a participation time limit forces both parties to sacrifice short-term political wins in favor of political compromise benefitting the municipality. It, therefore, constitutes positive reform of the struggling program.

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the Members of the Pennsylvania General Assembly with research and analysis on matters affecting local government." See 2013 TASK FORCE REPORT ON ACT 47 OF 1987, *supra* note 96, at ii.

159. For a full explanation of the 2014 reform imposing a time limit on Act 47 participation, see *supra* Part II.D.2.b.2.

160. See 2013 TASK FORCE REPORT ON ACT 47 OF 1987, *supra* note 96, at 25.

161. See *supra* Part II.D.2.b.2.

162. See *id.*

163. See 2013 TASK FORCE REPORT ON ACT 47 OF 1987, *supra* note 96, at 26.

164. See *supra* Part II.D.2.b.2.

165. See 2013 TASK FORCE REPORT ON ACT 47 OF 1987, *supra* note 96, at 27 (noting the research of Gerald Cross of Pennsylvania Economy League who found that "citizens view local government as the most personal level of government").

## 2. Analysis of the New Tax Options

Also included within the 2014 reform legislation is a provision allowing for municipal leaders to triple the Local Services Tax imposed on those working within the distressed municipality.<sup>166</sup> However, municipalities using this new revenue source are prohibited from simultaneously raising their earned income tax rate or imposing a tax on non-resident workers.<sup>167</sup> Furthermore, because the additional tax revenue comes from a previously established income source, the tax increase could in fact result in less revenue for distressed municipalities.<sup>168</sup> This decrease in revenue would result from businesses moving out of the distressed municipality in search of a more employee-friendly tax situation.<sup>169</sup> Therefore, because the consequences of this new revenue option are questionable, this specific provision fails to embody the drastic reform needed to ensure the program's success.

## 3. Analysis of the Early Intervention Program

The 2014 reform legislation also contains provisions that create a process for dismissing ineffective recovery coordinators<sup>170</sup> and an Early Intervention Program for municipalities at risk of financial distress.<sup>171</sup> The Early Intervention program, with its grant program for studies concerning the regionalization of services and municipal consolidation, is promising at keeping municipalities out of the Act 47 program because it orients them toward addressing underlying structural problems. This Early Intervention Program, however, offers little benefit to municipalities that are already declared financially distressed under the Act 47 program. In the 19 municipalities currently participating, early intervention is no longer possible, and the underlying drivers of financial distress, which the Early Intervention program attempts to address, have already taken hold.

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166. See *supra* Part II.D.2.b.3.

167. See Ryan Brown, *Local Services Tax Increase Put into Question*, ALTOONA MIRROR (Sept. 7, 2014), <http://www.altoonamirror.com/page/content.detail/id/593148/Local-services-tax-increase-put-into-question.html?nav=742>.

168. See Scorsone, *supra* note 2, at 24 (finding that, although officials often assume higher tax rates will lead to more revenue, the increase often drives households and businesses to relocate and leaves the government in an even greater financial hole).

169. See *id.*

170. See *supra* Part II.D.2.b.1.

171. See *supra* Part II.D.2.b.4.



*C. Recommendation for Further Legislative Modification*

While the Pennsylvania Legislature has answered the call to amend the Act 47 program since the *City of Scranton* decision, reform has failed to produce a program capable of alleviating municipal distress. Specifically, although a few of the 2014 reforms were substantial, they still failed to address the underlying and long-recognized causes of municipal distress. Therefore, in order to prevent future litigation and ensure Act 47's success, more legislative reform is needed to fulfill the public policy of Act 47 and involve all stakeholders in municipal recovery as the *City of Scranton* dissent urged.

In order to ensure lasting reform, the legislature must specifically address: (1) the crippling effect that the growth of tax-exempt property has had on distressed municipalities, (2) the growing municipal public pension crisis and its negative ramifications for municipalities and beneficiaries alike, and (3) the need for greater regionalization of public services and intergovernmental cooperation to address the decline of population within distressed cities. By acting on these issues, the legislature can finally stop nibbling around the corners of real reform and provide municipal leaders and recovery coordinators alike with the tools to allow municipalities to successfully exit the Act 47 program outside of the state receivership provision.

*1. Tax Reform for Non-Profit Entities*

In distressed municipalities, non-profit entities' tax-exempt status removes a significant source of property tax revenue. For example, in the Act 47 cities of Harrisburg and Johnstown, non-profit entities own nearly half the distressed municipalities' assessed property value.<sup>172</sup> Because many of the distressed municipalities participating in Act 47 had predominantly manufacturing or steel-centric industries,<sup>173</sup> the growth of non-profits such as hospitals and universities represents a transition to a service-oriented economy. This transition often results in non-profit institutions expanding and taking formerly revenue-generating property off the municipal tax rolls.<sup>174</sup> With their tax base now eroded, distressed municipalities are forced to pass the burden of making up such loss onto their remaining city residents, non-resident workers, and businesses remaining within the city. This increased tax burden on a limited set of

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172. See 2013 TASK FORCE REPORT ON ACT 47 OF 1987, *supra* note 96, at 29.

173. See Gannon, *supra* note 18, at 281.

174. See, e.g., Jim Lockwood, *As University of Scranton Expands, So Does Tension*, TIMES-TRIBUNE (Dec. 13, 2013), <http://thetimes-tribune.com/news/as-university-of-scranton-expands-so-does-tension-1.1590681>.

stakeholders has the potential to both drive citizens and businesses from distressed municipalities and create an economic development crisis.<sup>175</sup>

With both fiscal and economic development consequences for distressed municipalities,<sup>176</sup> this erosion of property tax revenue was specifically mentioned in the Municipalities Financial Recovery Act 2013 Task Force Report, which recommended creating a “state funding source to municipalities that have a high percentage of tax-exempt property within their municipal borders.”<sup>177</sup> Despite this proposal and the recognition by former Governor Ed Rendell that tax-exempt entities are “the single biggest problem” facing Pennsylvania’s municipalities,<sup>178</sup> the issue of property tax reform for non-profit entities went unaddressed in the 2014 reform legislation. This omission is likely the result of the state’s own fiscal woes and the difficulty of “finding a dedicated source of state funding.”<sup>179</sup> If the state cannot reserve funds for municipalities to offset the revenue lost from the tax exempt status of non-profit entities, then the legislature could narrow the property tax exemption for non-profits or more strictly enforce the existing exemption by ensuring non-profits continue to meet eligibility requirements.<sup>180</sup> The latter solution would have no effect on the state budget and would simultaneously ensure both a new source of revenue and reduced pressure on other municipal stakeholders.<sup>181</sup> Unfortunately, the Pennsylvania Legislature failed to adopt an above listed alternative in the 2014 reform legislation and thus, once again, left Act 47 participants without the tools to cure distress.

## 2. Comprehensive Municipal Pension Reform

A second cause of distress requiring remedy among Act 47 participants is the combination of high personnel costs for current

175. See Scorson, *supra* note 2, at 24.

176. See generally Susan Svrluga, *Struggling for Revenue, Local Governments Look to Nonprofits*, WASHINGTON POST (Dec. 22, 2013), [http://www.washingtonpost.com/local/struggling-for-revenue-local-governments-look-to-nonprofits/2013/12/22/aa334194-5e8b-11e3-95c2-13623eb2b0e1\\_story.html](http://www.washingtonpost.com/local/struggling-for-revenue-local-governments-look-to-nonprofits/2013/12/22/aa334194-5e8b-11e3-95c2-13623eb2b0e1_story.html) (explaining that governments around the country are re-examining their tax policy concerning non-profit entities in the face of revenue shortfalls).

177. See 2013 TASK FORCE REPORT ON ACT 47 OF 1987, *supra* note 96, at 44.

178. See PEW CHARITABLE TRUSTS, *THE STATE ROLE IN LOCAL GOVERNMENT FINANCIAL DISTRESS* 32 (2013).

179. See 2013 TASK FORCE REPORT ON ACT 47 OF 1987, *supra* note 96, at 44 (quoting the explanation of Task force member Representative Ross as to the likelihood of achieving such a reform).

180. See Daphne A. Kenyon and Adam H. Langley, Abstract, *The Property Tax Exemption for Non-Profits and Revenue Implications for Cities*, URBAN INSTITUTE (Dec. 9, 2011), <http://www.urban.org/publications/412460.html>.

181. See *id.*

employees and the legacy costs of retiree benefits. Arguing that state law “has tipped in favor of organized labor in arbitration awards and public pension . . . benefits,” the Pew Charitable Trusts’ report concerning states’ role in easing financial distress states that Pennsylvania will likely see the continued growth of municipal distress if the legislature does not address the proliferation of unfunded pension liabilities.<sup>182</sup> For example, in the Act 47 City of Scranton, a recent audit of the city’s pension funds by the state auditor general revealed the firefighter, police, and non-uniform pension funds will be unable to make scheduled payments in 2.5, 2.6, and 5 years, respectively.<sup>183</sup> Because Scranton and other cities would be obligated to make pension payments from their operating budget in the event of a shortfall, the widespread distress of municipal pension funds is alarming and poses a serious financial risk. While the City of Scranton may be an outlier as to the problem’s severity, the state as a whole has 7.7 billion dollars in underfunded pension liabilities.<sup>184</sup> This figure is so striking that Pennsylvania Auditor General Eugene DePasquale warned that many municipalities could be forced into bankruptcy, which would unilaterally cut retiree’s benefits and reduce city services.<sup>185</sup>

Although consolidating Pennsylvania’s 3,200 municipal pension plans<sup>186</sup> is the ultimate goal for some advocates like State Auditor General Eugene DePasquale,<sup>187</sup> the Municipalities Financial Recovery Act 2013 Task Force Report suggested that Act 47 itself should be amended to address all personnel costs by “allow[ing] municipalities to cap [costs] based on a government’s ability to pay.”<sup>188</sup> The task force report further endorses converting public safety retirement plans from defined benefit<sup>189</sup> to the less costly defined contribution plans.<sup>190</sup> In the

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182. See PEW CHARITABLE TRUSTS, *supra* note 178, at 31.

183. See Morgan-Besecker, *supra* note 86.

184. See Steve Esack & Emily Opilo, *Municipal Pensions in Pennsylvania Facing a Combined \$7.7 Billion Debt*, MORNING CALL (Jan. 14, 2015), <http://www.mcall.com/news/local/mc-pa-municipal-pension-crisis-20150114-story.html>.

185. See *id.*

186. See Steve Esack, *City and Business Leaders Call for Reforming Police and Fire Union Labor Law*, MORNING CALL (Apr. 16, 2013), [http://articles.mcall.com/2013-04-16/news/mc-pa-union-arbitration-change-20130416\\_1\\_sunshine-act-arbitrators-city-police-union](http://articles.mcall.com/2013-04-16/news/mc-pa-union-arbitration-change-20130416_1_sunshine-act-arbitrators-city-police-union).

187. See Marc Levy, *Auditor General: State’s pension crisis getting worse*, INDIANA GAZETTE (Jan. 15, 2015, 10:33 AM), <https://www.indianagazette.com/news/reg-national-world/auditor-general-states-pension-crisis-getting-worse,21320607/> (explaining that a recent push to consolidate all municipal pension plans into a statewide fund has died in house committees).

188. See 2013 TASK FORCE REPORT ON ACT 47 OF 1987, *supra* note 96, at 29 (quoting PEW CHARITABLE TRUSTS, *supra* note 178, at 31).

189. See CNN MONEY, *Ultimate Guide to Retirement*, [http://money.cnn.com/retirement/guide/pensions\\_basics.moneymag/index.htm?iid=EL](http://money.cnn.com/retirement/guide/pensions_basics.moneymag/index.htm?iid=EL)

future, this conversion could serve to entirely eliminate under-funded pension liability for all of Pennsylvania's municipalities and ensure more certain retirement security for future employees. Despite the broad recognition of this growing crisis and the strain it places on municipal governments, the 2014 reform legislation failed to address this substantial contributor to financial distress. Without this omission rectified in any way, municipalities such as Scranton lack the tools to alleviate distress within the new participation time limit.

### 3. Regionalization of Public Services

A third common cause of distress among Pennsylvania's municipalities is the erosion of the tax base resulting from population decline. Although no two distressed municipalities are identical, this overall decline in population among distressed municipalities mainly results from the conversion of local economies from manufacturing and steel-based to service-oriented.<sup>191</sup> As the descent of Chester, Pennsylvania into the Act 47 program demonstrates, the initial loss of industry and subsequent flight of taxpayers to the suburbs can have devastating effects on a municipality's finances.<sup>192</sup> Municipalities are subsequently faced with continually declining revenue projections. Because of political constraints, however, this decline in tax revenue often goes unmatched in adjustments to costly municipal services. Therefore, in order to correct this asymmetry, Act 47 should be amended to give municipal leaders and recovery coordinators power to make adjustments to essential municipal services.

For example, in Luzerne County, Pennsylvania, where local municipalities created a regional police department, police unions were actually supportive of the effort "because they saw there would be more full-time jobs, advancement and professionalism."<sup>193</sup> Furthermore, municipalities would benefit from regionalization of other services or intergovernmental cooperation. In testimony before a Dauphin County, Pennsylvania, panel considering regionalization, Pennsylvania Economy League representative Joseph Boyle promised future savings for municipalities willing to take on the difficult process of merging

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(last visited Feb. 6, 2015) (explaining that a defined benefit plan, as opposed to a defined contribution plan, promises a set payout upon retirement based on employer contributions).

190. See 2013 TASK FORCE REPORT ON ACT 47 OF 1987, *supra* note 96, at 29.

191. See PEW CHARITABLE TRUSTS, *supra* note 178, at 30.

192. See *id.*

193. See Barbara Miller, *Regionalizing Police Can 'Save' Police Departments, Dauphin County Panel Told*, PENNLIVE.COM (Nov. 13, 2014), [http://www.pennlive.com/midstate/index.ssf/2014/11/regionalizing\\_police\\_can\\_save.html](http://www.pennlive.com/midstate/index.ssf/2014/11/regionalizing_police_can_save.html).

services.<sup>194</sup> In the Municipalities Financial Recovery Act 2013 Task Force Report, the promise of regionalization of services, or at the very least intergovernmental cooperation, was also recognized as a “way for more efficient and less costly government, and thus make scarce local government resources go farther.”<sup>195</sup> To achieve that promise of cost savings, the 2013 Task Force Report recommended that the state provide distressed municipalities with incentives to engage less-distressed municipal neighbors in intergovernmental cooperation.<sup>196</sup> Although somewhat vague as worded, the 2014 reform legislation provided funding within its Early Intervention Program for studies concerning regionalization within at-risk municipalities.<sup>197</sup> However, the 2014 Act 47 reform legislation neglected to include similar funding for current Act 47 participants. Because such cost-sharing is necessary to prevent the future escalation of expenses, this omission is detrimental to Act 47’s effectiveness and should be corrected in future reform in order to save money and provide citizens with professional and well-funded essential services.

#### IV. CONCLUSION

Although Pennsylvania’s Act 47 statute is considered one of the most aggressive responses to municipal distress among the 19 states that have enacted such legislation, it has proven to be both politically contentious and objectively ineffective since its passage in 1987. The early history of Act 47 included a series of legal battles with public safety unions culminating in 2011’s *City of Scranton* Pennsylvania Supreme Court decision. Dealing a devastating blow to the effectiveness of the law, *City of Scranton* forced the legislature to overhaul Act 47 in hopes of better fulfilling its policy objective of curing distress. Although the 2014 Act 47 reform legislation undoubtedly made modest improvements, it failed to address underlying municipal distress causes—specifically, the growth of tax-exempt property within municipal boundaries, the growing crisis concerning municipal public pensions and current personnel costs, and the decline in population for municipal participants over the course of decades. Because such widely acknowledged structural problems were unaddressed in the 2014 reform legislation, Act 47 participants’ likelihood of successfully exiting the program remains poor. Therefore, in order to fulfill Act 47’s goal of

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194. See *id.*

195. See 2013 TASK FORCE REPORT ON ACT 47 OF 1987, *supra* note 96, at 28 (quoting a 1991 study of Act 47 conducted by the Penn State Department of Public Administration).

196. See *id.* at 43.

197. See *supra* Part II.D.2.b.1.

healing Pennsylvania's distressed municipalities, the legislature must act again, more courageously, to amend Act 47 and address the underlying causes of financial illness.

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